

**Letter of Findings: 01-20140104**  
**Individual Adjusted Gross Income Tax**  
**For the Year 2011**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is suspended by the publication of another document in the Indiana Register.

**ISSUE**

**I. Adjusted Gross Income Tax – Earned Income Tax Credit.**

**Authority:** IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3.1-21-1 et seq; IC § 6-3.1-21-6; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Stinson Estate v. United States, 214 F.3d 846 (7<sup>th</sup> Cir. 2000); Income Tax Information Bulletin 92 (May 2012); I.R.C. § 21; I.R.C. § 24; I.R.C. § 32; I.R.C. § 151; I.R.C. § 152.

Taxpayer protests that the Department incorrectly reduced her Indiana Earned Income Tax Credit which she claimed on her 2011 Indiana Individual Income Tax Return.

**STATEMENT OF FACTS**

Taxpayer, an Indiana resident, filed her 2011 federal and Indiana returns as head of household with two children ("Child 1" and "Child 2"). Taxpayer is divorced from the father of Child 1 and Child 2. Taxpayer took the Earned Income Tax Credit ("EITC") on the returns because she was the custodial parent of her two children ("Child 1" and "Child 2"). The Indiana Department of Revenue ("Department") investigated the Indiana return and reduced Taxpayer's Indiana EITC because the Department believed that she and her former spouse both claimed EITC on Child 2. Taxpayer protests that she is allowed the EITC as filed. A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional facts will be provided as necessary.

**I. Adjusted Gross Income Tax – Earned Income Tax Credit.**

**DISCUSSION**

In reviewing Taxpayer's 2011 individual adjusted gross income tax return, the Department reduced Taxpayer's EITC because the Department believed that Taxpayer and her former spouse both claimed the EITC on the same child, Child 2, which the Department believed contravened federal and, therefore, Indiana law. Taxpayer protested that she was allowed the EITC she claimed on her federal and Indiana returns because she was the custodial parent for Child 1 and Child 2 during 2011, and she and Child 1 and Child 2 otherwise met all the EITC requirements.

Tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

For income tax purposes, Indiana follows the federal tax scheme with certain modifications. IC § 6-3-2-1(b); IC § 6-3-1-3.5(b). Indiana also provides tax credits which a taxpayer may claim to reduce its taxable income. One of the tax credits Indiana provides is the EITC under IC § 6-3.1-21-1 et seq.

Similar to deductions, exemptions, and exclusions, tax credits "are matters of legislative grace." Stinson Estate v. United States, 214 F.3d 846, 848 (7<sup>th</sup> Cir. 2000). The taxpayer who claims a tax credit is required to retain records necessary to substantiate a claimed credit. Where such a credit is claimed "the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 101 (Ind. Ct. App. 1974).

As a preliminary matter, Taxpayer should note that according to IC § 6-3.1-21-6(a) and Income Tax Information Bulletin 92 (May 1, 2012), 20120425 Ind. Reg. 045120184NRA, the Indiana EITC was to be calculated based on

I.R.C. § 32 as it existed before being amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010:

## II. CURRENT CALCULATION OF THE EARNED INCOME TAX CREDIT

HEA 1001-2011 provided that the EITC for tax years beginning after Dec. 31, 2010, was to be calculated based on Section 32 of the Internal Revenue Code as it existed before being amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). P.L. 111-312 extended expiring provisions that were contained in Section 32 of the Internal Revenue Code. Indiana is not recognizing extensions contained in P.L. 111-312. Those provisions include the following: only two or more children instead of three or more children will be considered when calculating the maximum credit; there is no longer a differentiation between a single and joint return when calculating the amount of the credit; modified adjusted gross income will be considered in addition to earned income; and the alternative minimum tax subtract-off that had been removed will be reinstated for purposes of calculating the Indiana EITC. More information concerning the calculation of the credit can be found in the 2011 IT-40 individual income tax instruction booklet. To access the current-year booklet online, click on the Individual Income Tax Forms link at <http://www.in.gov/dor/3489.htm> and then select IT-40 Booklet.

Therefore, all references to federal EITC law are to the 2001 laws, which were the most recent laws updated prior to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

Being able to claim a dependent on a federal and Indiana tax return is tied to a number of tax credits. Taxpayers can deduct an additional personal exemption for each dependent that they claim. I.R.C. § 21. Taxpayers who claim a dependent may also be eligible for other child-related tax benefits, including but not limited to, the child and dependent care tax credit (I.R.C. § 151), the child tax credit (I.R.C. § 24), certain education credits (I.R.C. § 25A), and, at issue in this protest, the earned income tax credit (I.R.C. § 32) - if certain qualifications are met.

In circumstances that involve a divorce there may be questions as to which parent may claim certain credits. Generally, it is only the custodial parent who is eligible to claim child-related federal tax benefits. I.R.C. § 152(e)(1). However, the custodial parent may waive his or her right to claim a dependent in favor of the non-custodial parent, as Taxpayer did regarding Child 2 in this case. I.R.C. § 152(e)(2). However, even after releasing the claim to a dependent, the custodial parent would still be eligible to claim the EITC since I.R.C. § 32(c)(1). The dependency credit has no relationship to the EITC. To qualify for the EITC, Taxpayer would have to be an "eligible individual" under I.R.C. § 32(c)(1) with earned income that meets certain qualifications under I.R.C. § 32(c)(2).

In this case, Taxpayer was an "eligible individual" because she had a "qualifying child" under I.R.C. § 32(c)(3). The credit and phase out percentages of the EITC are calculated based on the number of "qualifying children" of a taxpayer under federal law. I.R.C. § 32(b).

Here, Taxpayer was the custodial parent of Child 2. She released her claim to Child 2's dependency to her former spouse, the child's father, as part of a divorce agreement. After the hearing, Taxpayer provided a copy of her divorce decree as evidence. Once a custodial parent releases a claim to the dependency exemption for a child, the custodial parent may not claim this or some of the other credits for the child; however, the custodial parent may still claim the EITC.

The Department did not question that Taxpayer met all the other EITC qualification requirements. The only contention by the Department related to the fact that Child 2's dependency was released to the non-custodial parent. As stated above, even though the custodial parent released Child 2's dependency to the non-custodial parent, this release of dependency has nothing to do with the custodial parent's ability to claim Child 2 for EITC purposes. Taxpayer correctly included Child 2 in calculating her credit percentage for EITC.

Therefore, based on the above, the Department was mistaken in reducing Taxpayer's EITC. Taxpayer rightly claimed Child 2 for EITC purposes.

## FINDING

Taxpayer's protest is sustained.

*Posted: 06/25/2014 by Legislative Services Agency*

